No. 12,159

IN THE

United States Court of Appeals

For the Ninth Circuit

In the Matter of
THE WESTERN PACIFIC RAILROAD COMPANY,
Debtor.

THE WESTERN PACIFIC RAILROAD CORPORATION,
Appellant,

vs.

THE WESTERN PACIFIC RAILROAD COMPANY,
Appellee.

Brief for Appellee

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Dated: San Francisco, California,
June 16, 1949.

PARKER PRINTING COMPANY, 180 FIRST STREET, SAN FRANCISCO

Subject Index

TEXTS, TREATISES AND OTHER MATERIAL

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Brief for Appellee

INTRODUCTORY

This is an appeal from an order of the United States District Court for the Northern District of California, Southern Division, in a railroad reorganization proceeding under Section 77 of the Bankruptcy Act, denying Appellant's petition for a "clarification" or, in the alternative, a "modification" of the injunctive provisions of the Court's Final Order in the reorganization case (Tr. 108) whereby the proceeding was terminated and the case closed (Tr. 115). Appellant sought such "clarification" or

"modification" for the declared purpose of permitting Appellant (Tr. 151, 156) "to institute a suit against, or to reform a suit heretofore instituted against," the reorganized railroad company, the Appellee herein, upon a claim that existed, if it existed at all, prior to the consummation of reorganization by the revestment of the railroad properties in the reorganized company on December 29, 1944 and prior to the Final Order of March 28, 1946. The bankruptcy court had previously held, by an order from which no appeal was taken (Tr. 149), that the claim asserted by Appellant "was released and discharged by said Final Order."

By its petition, denied by the court below, the Appellant prayed for relief from the injunctive provisions of the Final Order, avowedly to avoid being adjudged guilty of contempt in bringing its proposed suit. In its essence Appellant's contention here is that the bankruptcy court erred in refusing to modify its Final Order so as to permit Appellant to institute its belated suit upon a discharged and barred claim. Not only is the appeal devoid of merit but, in the view of the Appellee, the order sought to be reviewed is a non-appealable order. This will be shown. It will also be shown, *inter alia,* (1) that the claim upon which Appellant proposed to institute suit had been released and discharged by the Final Order in the bankruptcy proceeding and (2) that it had been conclusively so determined by a prior order of the bankruptcy court adjudging the Appellant guilty of contempt in having instituted such a suit.*

THE FACTS

(1) The Parties.

The Western Pacific Railroad Corporation, Appellant herein, is a holding corporation which formerly owned all of the stock

*In a footnote on page 5 of its brief Appellant affects to be aggrieved because Judge Goodman's remarks made upon the argument of the cause before him have not been reproduced in this record. Under the rules Appellant was free to designate whatever it desired for inclusion in the record (Rule 75, Rules of Civil Procedure) and was under no compulsion to join with Appellee in a "Stipulation for Record on Appeal" (Tr. 257).

of The Western Pacific Railroad Company, an operating rail carrier whose main line of railway extended from San Francisco to Salt Lake City. The latter company, in turn, owned all of the stock and substantially all of the bonds of Sacramento Northern Railway, likewise an operating rail carrier, with lines of railway extending from San Francisco to Sacramento and other points in the Sacramento Valley. Thus the Appellant controlled the two rail carriers.

The reorganized The Western Pacific Railroad Company is the Appellee herein.

(2) Events of Western Pacific Reorganization.

On August 2, 1935, The Western Pacific Railroad Company filed its petition for reorganization under Section 77 of the Bankrupcty Act in the United States District Court for the Northern District of California. Upon that same date the petition was approved as properly filed (Tr. 2). Reorganization trustees were shortly appointed and the railroad properties were under judicial administration for a period of more than nine years, terminating on December 29, 1944, when the properties were revested by order of the bankruptcy court in the reorganized The Western Pacific Railroad Company (Tr. 74, 88). This revestment was accomplished pursuant to a plan of reorganization prescribed by the Interstate Commerce Commission, 233 I.C.C. 409 (June 21, 1939) (Tr. 22), upheld by the Supreme Court of the United States, 318 U.S. 448 (March 15, 1943), and confirmed by the bankruptcy court (October 11, 1943) (Tr. 65). Under the provisions of the plan of reorganization the stock of The Western Pacific Railroad Company, all of which was owned by Appellant as above stated, was determined to be worthless and was required to be cancelled (Tr. 52, 53). All unsecured claims, including those filed by the Appellant, were likewise determined to be without value (Tr. 51-52). Thus the Appellant, though a party to the reorganization proceeding as sole stockholder and as an unsecured creditor, was denied participation in the reorganized company. The secured creditors only, viz., the Reconstruction

Finance Corporation, Railroad Credit Corporation, the First Mortgage Bondholders and the A. C. James Company, were permitted to participate in the reorganization, and bonds and stock of the reorganized company were issued to the secured creditors in conformity with the provisions of the plan (Tr. 50-51). Likewise as permitted by the plan, the old corporate charter was retained but all of the original bonds and stock were cancelled, being superseded by the bonds and stock issued by the reorganized company.

The stock and bonds of Sacramento Northern Railway, held by The Western Pacific Railroad Company as previously stated, were pledged as additional security under the new bond mortgages of The Western Pacific Railroad Company as reorganized (Tr. 24, 32).

After the consummation of reorganization by revestment of the railroad properties in the reorganized company on December 29, 1944, the reorganization proceeding was kept open until March 28, 1946, when the Final Order was made by the bankruptcy court terminating the proceeding and closing the case (Tr. 108, 111-12). This order included comprehensive provisions perpetually enjoining all persons "from instituting * * * any suit * * * against The Western Pacific Railroad Company, * * * directly or indirectly, on account of or based upon any right, claims or interest of any kind or nature whatsoever which any such person, firm or corporation may have had in, to or against the Debtor, or any of its assets or properties, on or before December 28, 1944 (except as specifically provided for or permitted by prior order of this Court), * * * and from interfering with * * * said company * * * by reason or on account of any obligation or obligations incurred by the Debtor or by the Trustees of the Debtor's estate on or before December 28, 1944 (except as specifically provided for or permitted by prior order of this Court) * * *" (Tr. 111-12). There was no appeal from the Final Order.

(3) Appellant's Prior Suit; Contempt Proceeding.

On August 24, 1946, Appellant brought suit in the United States District Court for the Northern District of California against Sacramento Northern Railway and the reorganized The Western Pacific Railroad Company, the Appellee herein, seeking judgment for the recovery of advances made by Appellant to Sacramento Northern Railway in 1928, or approximately eighteen years prior to the institution of the suit (Tr. 120). Such advances, together with unpaid interest accruals, were alleged to amount to $1,441,390.55. The alleged indebtedness was at no time an indebtedness of The Western Pacific Railroad Company. Nevertheless, the reorganized company was joined as a defendant for the purpose of asserting a so-called derivative claim in the right of Sacramento Northern Railway for a "retroactive readjustment" of divisions of rates on traffic interchanged between the two carriers and, based upon such retroactive readjustment, a determination of amounts retroactively payable to Sacramento Northern Railway. A money judgment was sought against the reorganized Western Pacific, in the alleged right of Sacramento Northern Railway but for the benefit of Appellant.

On August 30, 1946 an order was entered by the bankruptcy court, upon petition of Appellee, requiring Appellant to show cause why it should not be adjudged guilty of contempt for violation of the Final Order by instituting its action (Tr. 136). Appellant thereupon filed its Answer and Return to the order to show cause (Tr. 137) contending that its action was not in contempt of the Final Order because the alleged cause of action asserted derivatively against the reorganized company was entitled to priority over the mortgages of the reorganized company and was therefore excepted from the Final Order. To this Answer and Return the reorganized company (the Appellee herein) replied (Tr. 144), and the matter was briefed and submitted (Tr. 148). The bankruptcy court determined the issues adversely to Appellant by an order dated March 19, 1947, wherein the Court found and concluded (Tr. 149):

(a) that the claim asserted by Appellant against the reorganized company was one which, if it existed at all, existed on and before December 28, 1944 "and *was released and discharged* by said Final Order";*

(b) "that the assertion of such a claim *was and is barred and enjoined by said Final Order*";

(c) "that *the commencement of said action is not and has not been provided for or permitted by any order of this Court*"; and

(d) that "in commencing and maintaining said action" the Appellant had violated and was "guilty of contempt of said Final Order * * *."

The Court's order adjudged Appellant to be in contempt of the Court but provided that the Appellant might purge itself of its contempt by dismissing its suit as to the reorganized company. Appellant did not seek rehearing, neither did it appeal from the bankruptcy court's order of March 19, 1947 adjudging the Appellant in contempt (App.'s Br. 4). The order was allowed to become final. Appellant elected to purge itself of contempt by dismissing its action as to The Western Pacific Railroad Company (App.'s Br. 4). Its notice of dismissal, dated April 18, 1947, is in the record (Tr. 177).

(4) Appellant's Petition for "Clarification or Modification" of Final Order.

On September 30, 1947 Appellant filed a petition in the bankruptcy court for "clarification or modification" of the Final Order in the reorganization proceeding so as to permit Appellant to institute suit against the reorganized Western Pacific or to reform the suit previously instituted (Tr. 151). On October 29, 1948 the bankruptcy court made its order denying Appellant's petition (Tr. 248). From this order the Appellant has appealed.

It remains only to add that the claim which Appellant asserted in the suit held by Judge St. Sure's order of March 19, 1947 to

*All emphasis throughout this brief is supplied, unless otherwise expressly noted.

have been contemptuous, this being the same claim which Appellant proposes to assert in its contemplated suit provided that the Final Order should be modified so as to permit suit to be brought, was at no time presented to the bankruptcy court during the reorganization proceeding, which was open for a period of more than ten and one-half years extending from August 2, 1935 to March 28, 1946.

(5) Chronology.

The following chronology will be helpful:

Aug. 2, 1935	Order of bankruptcy court approving petition for reorganization as filed (Tr. 2).
Nov. 27, 1944	Order of bankruptcy court directing the revesting of the debtor's properties in the reorganized company and fixing December 29, 1944 as the date for the consummation of the plan of reorganization (Tr. 74, 88).
Dec. 29, 1944	Reorganization plan consummated by revestment of railroad properties in reorganized company.
Mar. 28, 1946	Final order of bankruptcy court terminating the proceedings and closing the case and enjoining the institution of any suit against the reorganized company on account of any right, claims or interest which may have existed on or before December 28, 1944 "(except as specifically provided for or permitted by prior order of this Court)" (Tr. 108, 111-12).
Aug. 24, 1946	Institution of suit by Appellant against Sacramento Northern Railway and the reorganized The Western Pacific Railroad Company seeking judgment against the latter, in the right of Sacramento Northern Railway, upon an alleged claim for a retroactive adjustment of divisions of rates (Tr. 120).
Aug. 30, 1946	Order of bankruptcy court requiring Appellant to show cause why it should not be adjudged guilty of contempt (Tr. 136).

Mar. 19, 1947	Order of bankruptcy court adjudging Appellant to be in contempt of the Final Order of the bankruptcy court by reason of the institution of its suit against the reorganized The Western Pacific Railroad Company (Tr. 147).
Apr. 18, 1947	Appellant's notice of dismissal of suit as to The Western Pacific Railroad Company (Tr. 177).
Sept. 30, 1947	Petition by Appellant to bankruptcy court for clarification or modification of Final Order so as to permit Appellant to institute suit against The Western Pacific Railroad Company or to reform the suit previousily instituted (Tr. 151).
Oct. 29, 1948	Order of bankruptcy court denying Appellant's petition for clarification or modification of Final Order (Tr. 248).

THE CASE TENDERED BY APPELLANT'S PETITION AND PROPOSED SUIT

(1) Objective Sought by Appellant's Petition.

On its own statement Appellant has no direct claim against Appellee, the reorganized The Western Pacific Railroad Company (App.'s Br. 18-19). Appellant represents that it has a valid claim against Sacramento Northern Railway, a wholly controlled subsidiary of the Appellee, for advances made to Sacramento Northern Railway in 1928, over twenty years ago, together with interest to date on the amount remaining unpaid (Tr. 199); that this amount is wholly uncollectible in fact from the Sacramento Northern Railway unless the latter has an enforceable claim against Appellee, the reorganized railway company, based upon a demand for "a retroactive adjustment" of the divisions of rates on traffic interchanged between Sacramento Northern Railway and The Western Pacific Railroad Company, now reorganized (App.'s Br. 8; Tr. 151, 155); that the claim thus asserted exists not only for "the post-reorganization period," i.e., the period subsequent to the revestment of

the railroad properties in the reorganized railroad company on December 29, 1944, but also for "the full period of judicial operation," i.e., from August 2, 1935 to December 28, 1944, and even for the period prior to August 2, 1935, when the debtor's petition for reorganization was filed (Tr. 156; App.'s Br. 23, 24); that Appellant, although it has not reduced its asserted claim against Sacramento Northern Railway to judgment, may nevertheless institute a derivative suit against the reorganized company, not in Appellant's own right but in the alleged right of Sacramento Northern Railway (App.'s Br. 18, 19), to recover on a supposed claim for a "retroactive adjustment" of divisions of rates; that by attempting to assert such a claim against the reorganized company Appellant runs the risk of being adjudged in contempt of the injunctive provisions of the Final Order of the bankruptcy court barring and enjoining the assertion of such claims (Tr. 152); that Appellant was entitled, as of right, to have the Final Order of the bankruptcy court "clarified"—i.e., construed—so as to permit the assertion of the alleged derivative claim against the reorganized company or, if such Final Order bars and enjoins the assertion thereof, to have it so "modified" as to authorize the suit which Appellant seeks leave to institute or reform (Tr. 156, 195; App.'s Br. 5); and that the bankruptcy court erred in denying Appellant the relief sought by its petition.

The issue tendered by Appellant's petition to the court below was whether Appellant was free to sue the reorganized The Western Pacific Railroad Company in a derivative cause of action in the alleged right of Sacramento Northern Railway upon a supposed claim for a retroactive adjustment of divisions of rates on traffic interchanged between the two carriers prior to the consummation of the Western Pacific reorganization, i.e., during the period of judicial operation as well as the period prior thereto. This same issue had previously been raised by Appellant and determined adversely to it by the bankruptcy court in the contempt proceeding. From this determination no appeal was taken (App.'s Br. 4) and that adjudication has accordingly long since become final.

(2) Identity of Cause of Action in Proposed Suit with Cause of Action in Suit Held to Have Been Contemptuous.

The suit instituted by Appellant on or about August 24, 1946 (Tr. 118, 138) and held to be contemptuous was upon the identical cause of action upon which Appellant now seeks leave to sue. The complaint in that action (Tr. 120), in common with the complaint tendered with Appellant's present petition (Tr. 197), alleged that Sacramento Northern Railway was indebted to Appellant for advances and interest thereon (Tr. 121, 127, 199, 204); both the original complaint and the proposed complaint, while professing to assert that Appellant's claim is paramount to the bond mortgages on the Sacramento Northern Railway's properties (Tr. 128, 205), seek to reach in equity what is said to be a claim of Sacramento Northern Railway against the reorganized company for a retroactive adjustment of divisions of rates on business interchanged between the two railroads, and Appellant's contention upon the present appeal (App.'s Br. Point I), in common with its contention in the previous case (Tr. 138), is that the claim which Appellant seeks to assert derivatively against the reorganized company is not within the injunctive provisions of the Final Order.

Although Appellant would have it appear otherwise (App.'s Br. 17-21), there is not the slightest difference in substance between the allegations of the original complaint which was held to have been contemptuous and the allegations of the proposed amended complaint. Both complaints involve exactly the same claim and are referable to precisely the same period of time. Appellant asserts (App.'s Br. 18-19) that the proposed amended complaint is different from the original in that it sets forth "a derivative cause of action against the reorganized Western Pacific Railroad Company not in favor of the *Appellant* but in favor of Sacramento Northern Railway * * *". (The emphasis is Appellant's.) The fact is that the complaints are alike in this respect also, for Paragraph 2 of the prayer of each complaint asks for a money judgment against Appellee and in

favor of Sacramento Northern Railway for the benefit of Appellant (Original Complaint, Tr. 135; Proposed Amended Complaint, Tr. 215). Appellant also relies upon the interpolation of the so-called "restrictive paragraph" in the proposed amended complaint (Tr. 212-13) but that paragraph does not change the nature or substance of the alleged cause of action by one iota. The supposed "restrictions" contained in this paragraph are two in number: First, as to the period prior to August 2, 1935, Appellant "restricts" itself to such amounts as "are entitled to priority over the then existing mortgage indebtedness of the defendant, The Western Pacific Railroad Company." This is but a paraphrase of the allegation in Paragraph VIII of the original complaint (Tr. 127) to the effect that the Appellant's claim is a first lien upon the revenues derived by the Appellee from traffic originating upon the Sacramento Northern Railway "to the extent that the plaintiff's claim against such revenues is entitled to priorities over the mortgages of the defendant, The Western Pacific Railroad Company." Second, as to the reorganization period from August 2, 1935 to December 1, 1944, the new paragraph "restricts" the claim to the amounts which have been assumed by the reorganized company (the Appellee) under the Assumption Agreement executed pursuant to the order of the reorganization Court. But this is precisely the same description which the Appellant itself gave to its original complaint in so far as it related to the period of the trusteeship. In its "Rejoinder" filed October 11, 1946, in connection with the contempt proceedings, Appellant said, "Clearly the injunction is inapplicable either by its terms or its intent to liabilities which arose out of the trusteeship operations and which the reorganized Railroad Company was required to assume by the order of this Court entered November 27, 1944. * * * All liabilities growing out of the traffic relations between these two properties were directly assumed by the Railroad Company under paragraph 2 of the Assumption Agreement of December 14, 1944. It would be strange indeed for this Court to punish

as a contempt the filing of a suit to enforce against the Railroad Company liabilities which the Court required the Railroad Company to assume." Therefore, the so-called "restrictive" paragraph in fact is not restrictive at all—it is merely repetitive. It does no more than restate in different words the content of the claim asserted by Appellant in its original complaint, which was held to be contemptuous.

Appellant is here attempting to relitigate the precise issue which was determined adversely to Appellant by Judge St. Sure's order in the contempt proceeding. In form Appellant's petition prayed for a "clarification or modification" of the Final Order so as to permit it to reinstitute or to reform a suit which it had dismissed under the compulsion of the adjudication of contempt. But in substance Appellant's objective is nothing other than a reversal of the prior decision from which no appeal was taken and which had become final. The bankruptcy court of necessity denied the petition (Tr. 248).

In order to preclude doubt or confusion as to the scope of the issues here involved, it should be stated that no question is presented in this proceeding as to Appellant's freedom to sue the Sacramento Northern Railway. Neither is any question presented in this proceeding as to Appellant's freedom to sue the reorganized Western Pacific on any liability with respect to rate divisions alleged to have arisen subsequently to the consummation of reorganization on December 29, 1944, without violating the injunctive provisions of the Final Order.

The only issue, we repeat, is whether the Appellant is free, or should be free, to sue the reorganized company on a claim which, if it existed at all (which Appellee denies), existed on and before December 28, 1944, and was an unsecured claim that could have been but was not filed or asserted in the reorganization proceeding. That issue is related solely to (1) "the pre-reorganization period" (1928-1935) and (2) the period of judicial operation (1935-1944).

It should be clear beyond the possibility of controversy that Appellant has been debarred of any right to assert against the

reorganized The Western Pacific Railroad Company any claim arising within a period preceding the consummation of reorganization on December 29, 1944. Appellant is precluded not only by the express provisions of the Final Order but also on principles of *res judicata*. We shall ask the Court so to rule.

Preliminarily, however, it is our duty to call the Court's attention to serious doubt as to the propriety of this appeal. In our view, the order sought to be reviewed is non-appealable.

ARGUMENT

I. The Order from Which This Appeal Is Taken Is Non-Appealable.

By its petition filed on September 30, 1947 Appellant sought relief in the bankruptcy court against that court's Final Order of March 28, 1946, terminating the reorganization proceedings and closing the case. The relief sought was either by way of construction (euphemistically called "clarification") or by way of modification of the Final Order, the purpose being to avoid the bar and injunctive provisions of the Final Order. Appellant has not appealed from the Final Order itself and that order had become final long before the filing of Appellant's present petition. Confessedly it is the injunctive provisions of the Final Order that constitute a threat to Appellant in its projected suit against the reorganized company (Tr. 152). Obviously, Appellant is aggrieved, if in truth it is aggrieved at all, by the Final Order. The later order of the bankruptcy court denying Appellant's present petition in no respect enlarges or alters the force or scope of the injunction—it merely leaves the injunction unchanged.

What Appellant is in fact seeking to accomplish is a review of the Final Order, long after it became final, by a petition for a "clarification" or modification. It is not claimed, nor could it be claimed, that the bankruptcy court was without jurisdiction to make the Final Order or that the Final Order was procured by fraud. Appellant merely seeks relief from its restrictive provisions. The appeal, if Appellant had any right of appeal at all,

should have been from the Final Order. It is elementary that an order denying a petition such as Appellant's petition here is not appealable and that the Final Order cannot be reviewed on an appeal from the order denying a petition for its clarification or modification.

It has long been the settled law, as declared by this Court in *Republic Supply Co. v. Richfield Oil Co.,* 74 F.2d 909 (C.C.A. 9, 1935), that:

> "The general rule is that no appeal will lie from an order denying a motion to vacate or modify a judgment, decree or order." 74 F.2d at 910.

As stated by the Circuit Court of Appeals for the Eighth Circuit in *Old Colony Trust Co. v. Kurn,* 138 F.2d 394 (C.C.A. 8, 1943, involving a railroad reorganization under Section 77:

> " 'Motions to vacate orders, motions for rehearings or for new trials, and like motions are addressed to the discretion of the trial court and are intended to call its attention to errors allegedly committed by it and to afford an opportunity for their correction. Orders granting or denying such motions are not appealable.' (Citing cases) *A motion to modify a judgment falls into the same category as a motion to vacate or for a rehearing. That this court is without jurisdiction of an appeal from an order dismissing a motion to modify a judgment is too well settled to require discussion.*" 138 F.2d at 395.

See also: *Nealon v. Hill,* 149 F.2d 883 (C.C.A. 9, 1945); *McCullough v. Kammerer Corp.,* 156 F.2d 343 (C.C.A. 9, 1946); *Brown v. Thompson,* 150 F.2d 171 (C.C.A. 8, 1945).

Obviously, Appellant's present petition, filed on September 30, 1947, was much too late to keep the time open for an appeal from the Final Order of March 28, 1946, even if it be assumed that such a petition, if timely filed, would have had the effect of keeping the time open to appeal from the Final Order. Equally fatal to the present appeal is the fact that the order from which the appeal is taken is the order denying Appellant's

petition for clarification or modification (Tr. 249, 250) and not the Final Order itself.

> "A refusal to modify the original order, however, *requires the appeal to be from the original order,* even though the time is counted" (when the petition was timely) "from the later order refusing to modify the original." *Pfister v. Northern Illinois Finance Corp.,* 317 U.S. 144, 149 (1942).

The rule has been similarly stated by the Circuit Court of Appeals for the Eighth Circuit in *United States v. Muschany,* 156 F.2d 196 (C.C.A. 8, 1946):

> "A *timely* motion which challenges the correctness of a judgment or order is intended to afford the trial court an opportunity to reconsider its action in entering the judgment and to amend it. The motion merely postpones the finality of the judgment and extends the time for appeal from the judgment. An appeal from the denial of such a motion is not an appeal, or the equivalent of an appeal, from the judgment or order the modification of which is sought. (Citing cases) *The appeal lies from the final judgment or order challenged by the motion, and not from the District Court's refusal to modify it.* (Citing cases)" 156 F.2d at 197.

To the same effect, see: *Bernards v. Johnson,* 314 U.S. 19 (1941); *Jones v. Thompson,* 128 F.2d 888 (C.C.A. 8, 1942); *Bass v. Baltimore & O. Terminal R. Co.,* 142 F.2d 779 (C.C.A. 7, 1944).

Here, no appeal was taken from the Final Order. The attempted appeal is from the order denying Appellant's petition for its modification. This order is not an appealable order and the appeal must therefore be dismissed.

Should the Court, however, be in doubt whether it may entertain this appeal, it will be necessary to consider the merits of the lower court's denial of Appellant's petition. We proceed therefore to a discussion of the merits.

II. Upon Principles of Res Judicata Appellant's Petition Was Properly Denied.

The essential identity of the issue sought to be raised in the suit which Appellant proposed to institute if its petition had been granted (Tr. 198) with the issue raised in the suit previously instituted by Appellant and held to be contemptuous (Tr. 120) has been shown. Elaboration will be unnecessary. Strive as it may, Appellant cannot disguise the fact that it proposes to sue the reorganized company, in the alleged right of Sacramento Northern Railway, for a retroactive adjustment of divisions of rates on traffic interchanged between the two carriers throughout a period of twenty years commencing in 1928, and that the prior suit was identical in character and directed to the same objective. Appellant seeks a money judgment against the reorganized Western Pacific, just as it sought a money judgment in its suit held to have been contemptuously brought.

Appellee resisted the Appellant's motion upon the ground that the precise issue had already been determined adversely to Appellant by Judge St. Sure's ruling in the contempt proceeding, and that the determination so made was *res judicata* of the issue (Tr. 163-68, 217-19). Clearly, this defense was determinative.

In the contempt proceeding before Judge St. Sure, arising out of Appellant's institution of suit upon the asserted claim for a retroactive adjustment of divisions of rates, the direct issue was whether the institution of that suit was violative of the Final Order in the reorganization proceeding (Tr. 115-47). On the issue thus tendered the bankruptcy court made express findings against the Appellant as follows (Tr. 149):

> "(f) That in and by said action The Western Pacific Railroad Corporation has asserted and now asserts a claim against the petitioner which, if it exists at all, existed on and before December 28, 1944, and *was released and discharged by said Final Order; that the assertion of such a claim was and is barred and enjoined by said Final Order;*

and that the commencement of said action is not and has not been provided for or permitted by any order of this Court.*

(g) That in commencing and in maintaining said action against The Western Pacific Railroad Company, The Western Pacific Railroad Corporation has violated and continues to violate said Final Order of this Court in this proceeding."

Based upon these findings,† the bankruptcy court made its order holding the Appellant to be in contempt (Tr. 149). These findings not only were pertinent to the issues but they held

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*Commenting upon the text of finding (f) here quoted, Appellant's brief makes the remarkable statement that "Judge St. Sure was referring only to the Appellant's claim against the Sacramento Northern Railway and was not referring to any claim that Sacramento Northern Railway * * * might have against the reorganized Western Pacific Railroad Company 'arising out of rate divisions' and 'interline settlements' * * *." (App.'s Br. 18) Appellant's statement is in error. There was no issue, and could have been no issue, before Judge St. Sure as to Appellant's claim against Sacramento Northern Railway since the Final Order did not purport to enjoin suits against that carrier. The precise issue before Judge St. Sure was whether Appellant's suit against the reorganized Western Pacific, in the asserted right of Sacramento Northern Railway, upon claims allegedly "arising out of rate divisions" and "interline settlements," was forbidden by the injunctive provisions of the Final Order. And the specific holding was that the assertion of Appellant's claim against the reorganized Western Pacific was "barred and enjoined" by the Final Order and that the commencement of the action had "not been provided for or permitted by any order of this Court." Appellant is not free to assert the contrary.

†It is hardly necessary to point out that on the issue of *res judicata* we look to the court's findings in the earlier action to determine what was there decided and what, accordingly, cannot be re-adjudicated. The prior decision is a bar, not only against a second suit on the same cause of action (here, on the issue whether the claim sought to be asserted by Appellant is within the injunctive provisions of the Final Order), but also is an estoppel against re-adjudicating in an action between the same parties those matters which were litigated and decided in the earlier proceedings (here, that the Final Order "released and discharged" Appellant's claim (Tr. 149) so that it no longer has any legal existence). See *Nev-Cal Electric Securities Co. v. Imperial Irr. Dist.,* 85 F.2d 886, 898 (C.C.A. 9, 1936); *Mason Lumber Co. v. Buchtel,* 101 U.S. 638 (1879); *Southern Pacific R. Co. v. United States,* 168 U.S. 1, 48 (1897); *Wyoming v. Colorado,* 286 U.S. 495, 507 (1931); *Sutphin v. Speik,* 15 C.2d 195, 201-03 (1940).

directly against Appellant's contentions that the bringing of the action was not violative of the Final Order (Tr. 128) and that the orders of the bankruptcy court did not affect, but actually excepted, the claim that Appellant was asserting (Tr. 140-42). This adjudication is not only *res judicata* that the assertion of a claim to a "retroactive readjustment" of divisions of rates is prohibited by the injunctive provisions of the Final Order, but is also *res judicata* that such claim, if it existed at all, existed on or before December 28, 1944, and was "released and discharged" by the Final Order. This means that it has been finally adjudicated between Appellant and Appellee that the alleged claim no longer has any existence and accordingly cannot now be asserted by Appellant.

It is plain upon the face of Appellant's petition, as well as upon the face of its brief, that Appellant is contriving to find some means by which to re-litigate the issue determined adversely to Appellant in the contempt proceeding before Judge St. Sure. On pages 3 to 5 of its brief Appellant quotes from its memorandum filed in the Court below to the following effect:

Appellant refers initially to what it terms the recitals (App.'s Br. 3), but which are in fact the findings (Tr. 149), of Judge St. Sure that the claim asserted by Appellant, if it existed at all, existed on or before December 28, 1944, that it was released and discharged by the Final Order and that the assertion thereof was barred and enjoined by the Final Order.

Next, Appellant registers its belief that Judge St. Sure's ruling was in error (App.'s Br. 3), and thereupon sets out three supposed optional procedures which were assertedly open to it for the correction of error. These supposed procedures are stated by Appellant to have been

(a) a petition for a rehearing before Judge St. Sure;
(b) an appeal to this Court; and
(c) a compliance with Judge St. Sure's order, purging Appellant of contempt, followed by the institution or reinstitution of suit under the protection of an order such as Appellant now seeks (App.'s Br. 4).

Appellant elected to pursue the third of these supposed choices, but it is plain that this third optional procedure was not available to Appellant *for the correction of asserted error.* If Appellant deemed Judge St. Sure's decision to have been erroneous, it was indispensably necessary either to petition for a rehearing or to take an appeal—otherwise the decision would become final. If it were allowed to become final, it would manifestly be *res judicata* of what Judge St. Sure had decided.* Appellant permitted Judge St. Sure's ruling to become final, with the result that it became a binding adjudication that the claim asserted by Appellant had been "released and discharged" and that the institution of suit upon it had been enjoined by the Final Order.

Judge St. Sure's order of March 19, 1947 might have been open to direct review upon appeal. It was not, and is not, subject to review otherwise. No appeal was taken. The order was allowed to become final, and the Appellant dismissed its suit as to The Western Pacific Railroad Company.

The order of March 19, 1947 is therefore *res judicata* of the issue. It precludes any redetermination of the scope and effect of the Final Order and bars the Appellant's attempted assertion of a claim to a retroactive adjustment of divisions of rates between the Sacramento Northern Railway and The Western Pacific Railroad Company. Hardly need it be added that it would be fruitless to modify injunctive provisions so as to permit suit upon a claim which has been "released and discharged."

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*It is well settled that orders and decisions in bankruptcy and in proceedings in reorganization are *res judicata* of the issues determined. See: *Stoll v. Gottlieb,* 305 U.S. 165 (1938) (*res judicata* effect given to an order cancelling the guarantee by a third party of bonds of the debtor); *Chicot County Drainage District v. Baxter State Bank,* 308 U.S. 371 (1940) (*res judicata* effect given to a readjustment order under the Municipal Debt Readjustment Act even though that Act was later, in another case, held unconstitutional by the Supreme Court); *In re National Public Service Corp.,* 88 F.2d 19 (C.C.A. 2, 1937) (applying the rule of *res judicata* in a case where the contention was that the bankruptcy court's order was too broad and went beyond the petition upon which it was made).

And it is hardly necessary to add that a decision, when it becomes final, is *res judicata* of what is decided, whether the decision be right or wrong.

Res judicata alone provides complete support for Judge Goodman's denial of Appellant's petition for a clarification or modification of the Final Order.

III. The Bankruptcy Court Correctly Determined, by Judge St. Sure's Order of March 19, 1947 in the Contempt Proceeding, That Appellant's Claim Is Barred by the Final Order of March 28, 1946 in the Reorganization Case.

While it would doubtless suffice to rest our defense of the challenged order upon principles of *res judicata* and to refrain from discussing issues which need not engage the attention of this Court, we shall nevertheless proceed to show that Judge St. Sure's determination of the issue which Appellant seeks to re-litigate was correct.

Appellant is proposing to sue a reorganized railroad company —a company which has been reorganized under a special statute whose remedial purposes have been judicially recognized—and which has been released and discharged from all of its pre-existing liabilities and obligations, as well as liabilities and obligations of the reorganization trustees, *except as certain of such liabilities and obligations have been expressly preserved.**

The essential objective of a railroad reorganization under Section 77 of the Bankruptcy Act is to obtain a reorganization which is compatible with the public interest. This consideration is emphasized in the decision of the Supreme Court which ap-

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*While the reorganized The Western Pacific Railroad Company is nominally identical with the debtor company which filed the application for reorganization, the old corporate charter having been retained as authorized by the reorganization plan (Tr. 231), in substance the reorganized company is distinct from the debtor company. All of the stock of the debtor company (held by Appellant) was found to be worthless and was required to be cancelled (Tr. 232-33) and the reorganized company has issued new stock, together with new bonds, to the secured creditors in conformity with the plan. There has been a complete change in capitalization and ownership. The Appellant's unsecured claims were found to be "without value" (Tr. 231-32). The reorganized company has been released and discharged from antecedent liabilities and obligations and has been given immunity against suit in the same measure and to the same effect as if a new corporation had been organized to consummate the reorganization.

proved the Western Pacific reorganization plan. *Ecker v. Western Pacific R. Corp.,* 318 U.S. 448, 475 (1943). It is of course indispensable to the effectuation of that objective that all claims for which provision is not made by the plan and by orders of the bankruptcy court shall be cancelled and discharged. That is the necessary effect of every railroad reorganization under Section 77.

The "remedial purposes" of the legislation embodied in both Section 77 of Section 77B, in relation particularly to the release and discharge of interests and claims of every character, have been repeatedly emphasized in court opinions. *City Bank Farmers Trust Co. v. Irving Trust Co.,* 299 U.S. 433, 438-40, 442, 444 (1937); *Brown v. Gerdes,* 321 U.S. 178, 181 (1944); *In re Sterba,* 74 F.2d 413, 417 (C.C.A. 7, 1935); *In re Greyling Realty Corp.,* 74 F.2d 734, 736 (C.C.A. 2, 1935); *Campbell v. Alleghany Corp.,* 75 F.2d 947, 949 (C.C.A. 4, 1935). See also: 5 *Collier on Bankruptcy* (14th Ed.) Sec. 77.02, pp. 468, 469; 6 *Id.* Sec. 11.18, pp. 3921-24.

In the very recent case of *Duryee, Trustee v. Erie Railroad Company* (C.C.A. 6, decided June 1, 1949, not yet officially reported) the underlying purposes of Section 77 were stated by the court as follows:

> "We are in complete agreement with the observations made by the district court in its opinion dismissing appellant's action to the effect that the purpose of the bankruptcy law and the provisions for reorganization could not be realized if the discharge of debtors were not complete and absolute; that if courts should relax the provisions of the law and facilitate the assertion of old claims against discharged and reorganized debtors, the policy of the law would be defeated; that creditors would not participate in reorganizations if they could not feel that the plan was final; and that it would be unjust and unfair to those who had accepted and acted upon a reorganization plan if the court were thereafter to reopen the plan and change the conditions which constituted the basis of its earlier acceptance.

"With respect to appellant's contention that to allow the reorganization order to bar the claim now asserted would be inequitable, fraudulent, and in contravention of public policy, we find nothing to justify such a conclusion. What has already been said with respect to the nonfiling of the claim sufficiently disposes of the contention that the barring of the present suit would be inequitable and against public policy."

The provisions of Section 77 respecting the discharge of debts and liabilities by the final decree in a reorganization proceeding do not differ in substance from the correlative provisions in Section 77B (now embodied in Chapter X) relating to other corporate reorganizations. The author of *Collier on Bankruptcy,* in the text last above cited, summarizes the purpose and effect of the discharge provision (Sec. 228(1)) in the following terms:

"Hence, unless specific provision is made otherwise, the final decree—which concludes the proceeding and closes the estate—discharges and terminates every right against and interest in the debtor of every kind, including liabilities incurred during reorganization, and including even the holders of claims or interests not filed or scheduled in the proceeding or who had no notice of it."

The true character of the claim which Appellant proposes to assert in its proposed suit should be clearly understood. Appellant's claim is for a money judgment against Appellee, the reorganized railroad company. This cannot be denied; the whole purpose of this appeal is to open the way for a modification of the Final Decree so as to permit Appellant to sue Appellee and obtain a money judgment against it. Appellant cannot represent, and does not represent, that the alleged indebtedness was at any time incurred or assumed either by the debtor company or its Reorganization Trustees. On the contrary, the indebtedness was incurred by Sacramento Northern Railway in 1928, or more than twenty years in the past. Appellant proposes to sue the reorganized railroad company, in a so-called derivative action in the alleged right of Sacramento Northern Railway, to obtain against

Appellee a judgment which will satisfy Appellant's claim against the Sacramento Northern Railway. The theory of the suggested derivative action is that the agreed divisions of rates between the Sacramento Northern Railway and The Western Pacific Railroad Company were unjust and inequitable to the former, and that there should be a "retroactive readjustment" of such divisions, followed by recovery of a judgment against Appellee for the amount shown to be due thereunder, in the right of Sacramento Northern Railway but for the benefit of Appellant.*

Thus the claim which Appellant proposes to assert attacks twenty years of *closed interline accounts.* The claim covers the prereorganization period of approximately seven years (1928-1935) and the period of judicial operation of more than nine years (1935-1944). This statement, without more, should suffice to reveal the fantastic character of Appellant's program.

Undoubtedly this Court understands that the Appellant itself, as the controlling parent corporation of both Sacramento Northern Railway and The Western Pacific Railroad Company, was wholly responsible for the divisions of rates of which it now seeks to complain. Moreover, in every year from 1928 to 1944

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*It is not a matter of any consequence, notwithstanding Appellant's suggestion to the contrary (App.'s Br. 25, 26), that Sacramento Northern Railway was not a party to the reorganization proceeding. The cases cited on page 27 of Appellant's brief, viz: *Thompson v. Terminal Shares, Inc.*, 104 F.2d 1 (C.C.A. 8, 1939) and *Callaway v. Benton,* 336 U.S. 132 (1949), are not remotely in point.

The facts are that the stock and bonds of Sacramento Northern Railway were pledged under a bond mortgage of the prereorganized Western Pacific, as Appellant well knew. As Appellant also knows, the stock and bonds of Sacramento Northern Railway are now pledged under the new bond mortgages of the reorganized company. Yet Appellant feels entirely free to argue in this Court that its unsecured claim against the Sacramento Northern Railway should take precedence not only over the latter's bond mortgage and the bond mortgage of the prereorganized Western Pacific but also over the new bond mortgages of the reorganized Western Pacific. This would not only disregard and reverse the normal order of "absolute priority" but would completely evade the objectives and consequences of reorganization. Appellant's unique and quite unorthodox concept of "equity" and "good conscience," to which it persistently appeals, stands forth in bold relief both here and elsewhere in its brief.

the Appellant knew the facts. Appellant knew that throughout the entire term of the reorganization proceeding, extending from August 2, 1935, until the entry of the Final Decree on March 28, 1946, the bankruptcy court was open to receive and hear all claims. Appellant was a party to the reorganization proceeding, but *the claim which Appellant proposes to assert in its contemplated suit against the reorganized railroad company, arising out of transactions of the debtor company from 1928 to 1935 and transactions of the reorganization trustees from 1935 to 1944, was never filed or presented in the reorganization proceeding.*

Reorganization proceedings would be a trap for the unwary and a haven for insiders if claims of this character, predating the inception of the proceedings, could be withheld until the claims of other interests have been scaled down or barred by reorganization, and thereafter impressed upon the assets in the hands of the reorganized company, thereby taking precedence over the secured creditors held entitled to participate in the reorganized enterprise. It would be a travesty if such consequences could follow the consummation of reorganization.

Appellant has been forced to concede upon brief (App.'s Br. 12-14) that the claim which it desires to assert in its proposed suit is within the prohibitions of the discharge and injunctive provisions of the Final Order, unless the assertion of that claim is "specifically provided for or permitted by prior order of this court," i.e., of the bankruptcy court. Appellant represents that its proposed suit is within the "exceptive clauses" of the Final Order. It purports to find authority for the institution of its cause of action in the initial order of the bankruptcy court, entered on August 2, 1935 (Tr. 2), by which "the debtor is authorized, in its discretion," *inter alia,* to settle and pay "claims arising out of rate divisions" and "interline settlements" (Tr. 4-5). (It should be noted that the debtor was "authorized," *not directed,* to make such payments "in its discretion.") The authority so given to the debtor was reaffirmed in the court's

subsequent order of September 23, 1935, appointing the Reorganization Trustees (Tr. 16, 21).

Appellant would seek to persuade this Court that its proposed suit is for an "interline settlement" and that such suit is within the "exceptive clauses" of the final order. Appellant advanced precisely the same contentions in the contempt proceeding before Judge St. Sure. (See answer and return of The Western Pacific Railroad Corporation to order to show cause, filed September 23, 1946 (Tr. 137, 140-1).) But Judge St. Sure was not misled by Appellant's contention. He expressly found that Appellant's claim had been *"released and discharged"* by the Final Order and that the institution of the suit *"has not been provided for or permitted by any order of this Court"* (Tr.. 149).

It should be exceedingly plain, without the aid of Judge St. Sure's findings and conclusions, that the suit which Appellant proposes to institute is not for an "interline settlement." The term "interline settlement" is a conventional term, having in railroad and accounting practice a well recognized meaning. An "interline settlement" is the payment by one carrier to another of the net balance shown to be due under the "interline accounts" rendered by each carrier to the other for the same period. Such interline accounts are commonly rendered monthly, followed by interline settlements which are also made monthly. These are not "running accounts." The accounts are rendered and the settlements are made in accordance with "rate divisions" which are set forth in division sheets. Rate divisions are customarily agreed upon by the participating carriers and, in the absence of agreement, may be fixed by the Interstate Commerce Commission. The phrase "claims arising out of rate divisions" is simply an alternative for the interline accounting which precedes the making of "interline settlements." Accordingly, permission to pay "claims arising out of rate divisions" is the equivalent of permission to make or pay "interline settlements," which of necessity are based upon rate divisions.

It is clearly revealed, both in Appellant's petition (Tr. 154-55) and in its brief upon this appeal, that its proposed suit is not in fact upon "interline settlements." It is stated repeatedly throughout Appellant's brief that it is seeking what it terms "a retroactive adjustment of revenue divisions" or "a retroactive readjustment of divisions" (App.'s Br. 10, 21, 22, 23). This would not be an "interline settlement." These two terms are incompatible. In our view it is sheer casuistry to suggest that a suit contemplating "a retroactive readjustment of divisions," to be accomplished avowedly "as the result of an intricate accounting" (Tr. 208), is the equivalent of a suit for an "interline settlement."*

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*Quite belatedly, Appellant has been brought to realize that it could not in any event secure its desired "retroactive readjustment" of divisions without application to the Interstate Commerce Commission for administrative relief (App.'s Br. 10-11). Appellant states that this "involves a factual inquiry and a readjustment of divisions committed to the Interstate Commerce Commission by the Interstate Commerce Act" (App.'s Br. 10). (Parenthetically, Appellant here starkly reveals that its proposed suit is in no sense for an "interline settlement." Its objective is of an entirely different character.) But Appellant overlooks the circumstance that the authority given to the Commission to adjust divisions *retroactively* under the applicable provision of the statute (Section 15(6), reproduced on pages 9-10 of Appellant's brief) is restricted to "the period subsequent to the filing of the complaint or petition or the making of the order of investigation." Thus the Commission could not prescribe divisions retroactively for any part of the period with which we are here concerned.

Appellant has also failed to note that Section 15(6) differs in this respect from Section 15(13) of the Act involved in *El Dorado Oil Works v. United States,* 328 U.S. 12 (1946), upon which the Appellant purports to rely (App.'s Br. 11).

No court has authority to prescribe divisions of rates, either prospectively or retrospectively. This is for the reason that the division of joint rates, like the making of rates, "is a legislative and not a judicial function." *Terminal R.R. Assn. v. United States,* 266 U.S. 17, 30 (1924); *Brimstone R.R. Co. v. United States,* 276 U.S. 104 (1928). In the case last cited the Supreme Court stated that "the studied purpose" of Section 15(6) was "to grant no power to require readjustments of past receipts from agreed joint rates." See also *United States v. Baltimore & O. R. Co.,* 284 U.S. 195 (1931).

It is only too clear that if the Final Order were to be modified upon Appellant's petition so as to permit the institution of its proposed suit the reorganized company would be involved in protracted and costly proceedings before the Interstate Commerce Commission, followed by a proceed-

Even if the Appellant had been able to persuade Judge St. Sure, or if it could now persuade this Court, that its proposed suit is for an "interline settlement," it could not establish its contention that such a suit is within the "exceptive clauses" of the Final Order. It is incumbent upon Appellant to show that a *"suit"* has been "specifically provided for or authorized by prior order of this Court." No such authorization can be found. It is not to be found, as Appellant would find it, in Order No. 1, entered on August 2, 1935, which, as we have noted, goes no further than to "authorize" the debtor (and subsequently the Reorganization Trustees) "in its discretion" to make interline settlements. This authorization cannot be expanded in such fashion as to permit the institution of *"suit"* by or in behalf of any claimant respecting such "interline settlements."

This Court will understand that the authorization to pay interline settlements, in common with the authorization to pay operating expenses, reflects the common practice in reorganization proceedings to permit the payment of necessary expenses incurred within a reasonable period, usually not exceeding six months, prior to the institution of the proceeding. The expenses must have been incurred in order to keep the railroad a going concern. The objective is to insure that the maintenance of a necessary service will not be suspended by reason of impairment of the financial credit of the operating company.*

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ing in court to the end that the Appellant might obtain its "judicial settlement." This would be completely in derogation of one of the prime objectives of railroad reorganization proceedings.

The Court will not overlook the Appellant's declaration of its bizarre proposal to have the rate divisions so recast as to make the reorganized company accountable "for all of the revenue derived from the full line haul except the out-of-pocket operating cost applicable thereto" (Proposed Complaint, Par. IX; Tr. 208). And yet Appellant would seek to persuade this Court that its proposed suit is for an "interline settlement" within the meaning of that term included in the bankruptcy court's initial order of August 2, 1935.

*The authorities listed in the footnote on page 20 of Appellant's Brief confirm what has been said herein respecting the circumstances under

It should be clearly understood that an order of a bankruptcy court authorizing a receiver or trustee to pay necessary operating expenses, including the making of interline settlements, "in his discretion," does not vest the claimant with any right or priority over mortgage liens. It gives to the claimant no right of action. The order is permissive merely. If a receiver or trustee fails to pay a particular claim, "the parties in interest may rightfully challenge its priority even if it were within the very letter of the order of appointment of the receiver." These are the words of the Supreme Court in *Louisville, E. and St. L. R. Co. v. Wilson,* 138 U.S. 501, 506 (1891). See also: *Gregg v. Metropolitan Trust Co.,* 197 U.S. 183 (1905); *Atchison, T. & S. F. Ry. Co. v. Osborn,* 148 Fed. 606, 610 (C.C.A. 8, 1906); *Fordyce v. Omaha, Kansas City & E. R.R.,* 145 Fed. 544, 555 (C.C., W.D. Mo. 1906); *Monsarrat v. Mercantile Trust Co.,* 109 Fed. 230, 231 (C.C.A. 6, 1901); *Bankers' Trust Co. v. Florida East Coast Ry. Co.,* 9 F. Supp. 258, 261 (S.D. Fla. 1934).

Thus, even if Appellant's extraordinary claim had been presented to the Trustees (as it was not) and the Trustees had declined to pay it, Appellant's case would not thereby be fortified. Orders of this character authorizing the payment of claims create no rights, preferred or otherwise, in the claimants, and are permissive only.

The claim which Appellant seeks to maintain in its proposed suit is not within either the terms or purposes of the initial order of the bankruptcy court authorizing the payment of "interline

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which claims for necessary operating expenses may be paid, as well as the reasons underlying the established practice. Thus the quotation from 3 Jones on Bonds and Bond Securities refers to "balances due other railroads and lines of transportation on account of passenger tickets and freight charges." The text-writer also refers to "the payment of limited amounts due connecting roads for materials and repairs and for unpaid ticket and freight balances, the outcome of indispensable business relations where an interruption of such relations could be a probable result in case of non-payment." Appellant cannot bring its claim within these specifications. It is not proposing to institute suit for "balances due" or "for unpaid ticket and freight balances."

The three decisions cited in the footnote set forth the rule substantially as we have stated it.

settlements." It is nothing other than factual distortion to represent that Appellant is proposing to sue upon "interline settlements."

We have noted that the claim which Appellant proposes to assert in its contemplated suit is referable in part to the pre-reorganization period (1928-1935) and in part to the period of judicial operation (1935-1944). This claim was at no time presented to the bankruptcy court in the reorganization proceeding. Failure to assert the claim while the proceeding was pending is fatal to its assertion after the entry of the Final Order terminating the proceeding and closing the case.

Claims which might have been but were not presented during the reorganization proceeding may not be later asserted. *McColgan v. Maier Brewing Co.,* 134 F.2d 385 (C.C.A. 9, 1943), cert. den. 320 U.S. 737; *Standard Steel Works v. American Pipe & Steel Corp.,* 111 F.2d 1000 (C.C.A. 9, 1940); *American Service Co. v. Henderson,* 120 F.2d 525 (C.C.A. 4, 1941); *In re Corona Radio & Television Corp.,* 102 F.2d 959 (C.C.A. 7, 1939).

It is beyond question that liabilities alleged to have been incurred by the debtor prior to the inception of the reorganization proceeding are released and discharged by the Final Order except as certain claims, or classes of claims, are expressly reserved in the Final Order. It is also well established that liabilities alleged to have been incurred by a receiver or trustee in the course of administering the trust estate do not survive the receivership or trusteeship and do not become liabilities of the trust properties after their revestment in the reorganized company "unless the court has so directed." This Court has authoritatively so determined in *McColgan v. Maier Brewing Co.,* 134 F.(2d) 385 (C.C.A. 9, 1943), cert. den. 320 U.S. 737.

That case involved California franchise taxes which allegedly accrued during a bankruptcy receivership. The Franchise Tax Commissioner presented no claim and, after a plan of composition was effected and confirmed by the court, the corpora-

tion's properties were turned back to it and the proceedings were terminated. The corporation then conducted its own affairs until a year or so later when creditors petitioned for a reorganization under Chapter X. In the reorganization proceedings the Franchise Tax Commissioner filed a claim for the franchise taxes that accrued during the bankruptcy receivership. In upholding the order rejecting this claim, because it was not presented in the bankruptcy receivership or otherwise provided for, this Court held that though the obligation for the taxes was not a provable debt owing by the corporation but a receivership obligation (134 F.2d at 387), it was nevertheless barred, saying:

> "Upon confirmation of the plan for composing the debts of the Maier Brewing Company, the receiver was discharged and the property unconditionally turned back to the corporation. Does the property so returned remain liable for debts incurred by the receiver in the course of administration? We understand not, unless the court has so directed. The general rule is thus stated in Clark on Receivers (2nd edition 1929), page 108 volume 1: 'The effect of the discharge of a receiver and surrender of jurisdiction over the trust, without any reservation as to existing claims, is to release not only the receiver, but also, the property from further liability.' "

The Court said further:

> "Of course if these taxes had been assessed and a claim made upon the receivers for their payment they would, like administrative expenses generally, have occupied a preferred status. But the statute does not dispense with the necessity for making timely demand for their payment in the receivership proceeding. As much now as in the past orderly procedure requires that administrative expenses be settled while the property yet remains in the custody of the court." 134 F.2d at 387, 388.

The objective to be attained by a statutory reorganization, with respect particularly to the discharge of claims and demands, has been expressed by the Supreme Court in *City Bank Farmers*

Trust Co. v. Irving Trust Co., 299 U.S. 433 (1937), in the following terms:

> "The purpose of Section 77B was to facilitate rehabilitation of embarrassed corporations by a scaling or rearrangement of their obligations and shareholders' interests, thus avoiding a winding up, a sale of assets, and a distribution of the proceeds. A salient element in such a reorganization is *the discharge of all demands of whatsoever sort, executory and contingent, presently due or to mature in the future.*" 299 U.S. at 438-39.

These principles are equally applicable, and the remarks equally pertinent, to a railroad reorganization under Section 77.*

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*On page 22 of its brief Appellant cites five decisions in ostensible support of its assertion that those who receive assets from receivers and trustees are customarily required to enter into agreements whereby claims arising out of the acts of the receivers or trustees are protected despite their discharge. None of these decisions is relevant or pertinent. In no instance was a statutory reorganization involved.

The decisions of the Supreme Court in *Texas and Pacific Ry. Co. v. Johnson,* 151 U.S. 81 (1894) and *Texas and Pacific Ry. Co. v. Bloom,* 164 U.S. 636 (1897), arose out of a single railroad receivership and resulted in similar holdings. It appeared in the *Johnson* case that a receiver had been appointed "in an amicable suit at the instigation of the company and for the company's own purposes * * *." 151 U.S. at 99. After the company's purposes had been accomplished, the property was returned to its owner *without reorganization pursuant to a foreclosure sale or otherwise.* It was the conclusion of the court below that the plaintiff's claim, which arose during the receivership, could be maintained against the railroad company since, under the circumstances there disclosed, "the acts of the receiver might well be regarded as the acts of its own servant, rather than those of an officer of the court, which under such circumstances he would only be *sub modo.*" *Ibid.* In its opinion affirming the judgment of the lower court the Supreme Court pointed out *inter alia* that "the property was not sold but merely redelivered to the company." Moreover, "No judgment *in rem* was entered * * *." *Id.* at 102.

The decisions in *Bartlett v. Cicero Light, Heat & Power Co.,* 52 N.E. 339 (Ill. 1898); *Anderson v. Chicago R. I. & P. Ry. Co.,* 175 N.W. 583 (Iowa 1920); and *Stuart v. Dickinson,* 235 S.W. 446 (Mo. 1921), which are also cited in Appellant's brief, arose under circumstances substantially similar to those presented in the two cases just reviewed. In each of these three cases, upon the discharge of the receiver the property of the defendant corporation was returned to its owner, without reservation and likwise without reorganization. The rulings followed the rulings of the Supreme Court in the *Johnson* and *Bloom* cases.

The case of *Hanlon v. Smith,* 175 Fed. 192 (N.D. Iowa 1909) arose

The statute explicitly declares that, upon confirmation of the reorganization plan by the judge, the provisions of the plan shall be "binding upon * * * all creditors secured or unsecured, whether or not adversely affected by the plan, and whether or not their claims shall have been filed, and, if filed, whether or not approved, including creditors who have not, as well as those who have, accepted it." Section 77(f) of Federal Bankruptcy Act, 11 U.S.C. Sec. 205(f).

The plan of reorganization, formulated by the Interstate Commerce Commission and confirmed by the bankruptcy court, expressly finds that the unsecured claims of The Western Pacific Railroad Corporation are "without value" (Tr. 51-52). *Western Pac. R. Co. Reorganization,* 233 I.C.C. 409, 452 (1939).

Appellant relies upon the assumption agreement, for which provision is made in the revestment order, which Appellant terms the *"nexus"* of Appellant's asserted right to sue the reorganized company for the account of the Sacramento Northern Railway (App.'s Br. 21). Appellant's reliance is misplaced. The agreement is in conventional form and is plainly designed, first, to free the trustees from further liability or responsibility of any character and, second, to impose upon the reorganized company such liabilities and obligations as have been expressly preserved by orders of court. But the agreement cannot be construed, as Appellant would construe it, to preserve all manner of claims arising out of acts of the trustees, despite their discharge from personal liability (App.'s Br. 22).

Appellant's error is readily demonstrable. The assumption

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out of an equity receivership terminating in a sale under order of court. In view of an unrestricted requirement in the decree of sale and the order of confirmation that the purchaser "should assume and pay all the liabilities incurred by the receivers at any time before their final discharge * * *" (175 Fed. at 193), it was ruled that suit could be maintained upon a claim arising during the receivership.

Appellant has failed to produce a single decision arising out of any corporate reorganization under Section 77 or Section 77B, or even under a foreclosure sale in an equity receivership, holding that liabilities incurred by trustees or receivers survive the reorganization except as provision is made for such survival by specific court order.

agreement is not to be construed in dissociation from the order of court requiring it to be made, nor in disregard of the provisions of the plan of reorganization with which it is required to be "consistent." The agreement cannot give life to claims which were lacking the prerequisite of court allowance, nor can it be the source of new liabilities or obligations. It cannot mean more than that the reorganized company is to assume only the valid and outstanding obligations and liabilities of the debtor company and the debtor company's trustees, and only those which are preserved under the plan of reorganization. That such is the true effect of the agreement of assumption is shown by paragraph 9 of the revesting order, requiring the agreement to be made, reading in part that—

> *"said Railroad Company shall assume only the valid and outstanding obligations and liabilities of the debtor or the debtor's Trustees, other than unsecured claims against the debtor not entitled to priority over existing mortgages, which unsecured claims are hereby cancelled and discharged, and only such obligations and liabilities as are preserved under the plan of reorganization and are not limited or discharged by the prior orders of this Court."* (Tr. 74, 87)

The quoted language is authoritative and conclusive. It forbids a construction which would require the reorganized company to assume *all* liabilities and obligations which may have been incurred by or may be asserted against the reorganization trustees. It permits the assumption only of "valid and outstanding obligations and liabilities of the debtor or the debtor's Trustees."

Certain it is that Appellant's claim, which has never been brought to the attention of the bankruptcy court or otherwise asserted, cannot fall within this characterization. The claim in its nature is an extraordinary one. It is an established principle that reorganization trustees have no authority to charge the estate with liability without the sanction of an order of the court.*

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*The same principle governs receivers. *Chicago Deposit Vault Co. v. McNulta,* 153 U.S. 554 (1894).

In recognition of this principle, the bankruptcy court, in Order No. 1, expressly withheld authority to incur any extraordinary expense without the prior approval of the court. This order authorized the debtor to manage and conduct its business as a railroad company in the customary manner but this authority was expressly qualified by restrictive provisions reading in part as follows (Tr. 4):

> "The authority given by the foregoing shall not include authority to incur expense, other than such as is necessary in the course of the usual and ordinary maintenance and operation of the debtor's property. Any extraordinary expense and expense incident to reorganization of the debtor *shall be subject to the prior approval of the Court.*"

These provisions were reaffirmed in the subsequent orders of the court appointing and confirming the trustees (Tr. 16, 21).

It should be plain that a liability of the remarkable character now lately asserted by Appellant could not have been incurred "in the course of the usual and ordinary maintenance and operation of the debtor's property." On the contrary, such liability would have been an "extraordinary expense," and since it was at no time brought to the attention of or approved by the bankruptcy court, it could not have become an obligation of the reorganization trustees. It follows inevitably that it could not have been assumed by the reorganized company.

The Court's final order of March 28, 1946 declares, *inter alia,* that:

> "The Western Pacific Railroad Company is released and discharged forever from all of its debts and liabilities existing on or before December 28, 1944, whether or not the same have been presented and allowed in these proceedings, and said reorganized Company is free and clear of all such rights, claims, interests, liens, encumbrances, debts, obligations and liabilities, except as otherwise expressly provided in said order." (Tr. 108, 109)

(The "said order" referred to in the closing words of the foregoing is the revesting order of November 27, 1944, which con-

tains no provision preserving claims of the character here attempted to be asserted by Appellant.)

The injunctive provisions of the Final Order are commensurate with the "release and discharge." By paragraph 6 of the Final Order "All persons * * * are hereby perpetually restrained and enjoined from instituting * * * any suit * * * against The Western Pacific Railroad Company, * * * directly or indirectly, on account of or based upon any right, claims or interest of any kind or nature whatsoever which any such person, firm or corporation may have had in, to or against the Debtor, or any of its assets or properties, on or before December 28, 1944 (except as specifically provided for or permitted by prior order of this Court), * * * and from interfering with or taking steps to interfere with said Company, its officers and agents, or the operation of the lines of railroad or properties or the conduct of the business of said Company, by reason or on account of any obligation or obligations incurred by the Debtor or by the Trustees of the Debtor's estate on or before December 28, 1944 (except as specifically provided for or permitted by prior order of this court), * * *." (Tr. 111-13)

We again note that no sanction can be found in any prior order of the Bankruptcy Court for the institution of suit upon the Appellant's claim.

In summary, the assertion of Appellant's claim against the reorganized The Western Pacific Railroad Company is barred by the provisions of the statute, by the terms of the reorganization plan, which has long since been consummated, and by the provisions of the court's Final Order in the reorganization proceeding. It was correctly determined, by the order in the contempt proceeding before Judge St. Sure, that this claim has been "released and discharged" and that the institution of suit upon it "has not been provided for or permitted by any order of this Court."*

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*The case of *Booth v. Hoskins,* 75 Cal. 271 (1888), cited by Appellant, is completely irrelevant (App.'s Br. 7, 28, 29). That case holds merely that a landowner, who would quiet his title against a mortgage that has

IV. Appellant Has No Standing to Assert Claims of Sacramento Northern Railway Against Appellee.

A claimant who has not reduced his claim to judgment is not entitled to maintain a creditor's bill or to seek any equitable relief in connection with claims which the alleged debtor may have against third persons. *Swan Land & Cattle Co. v. Frank,* 148 U.S. 603 (1893); *Hoehn v. Crews,* 144 F.2d 665 (C.C.A. 10, 1944), cert. den. 323 U.S. 773; *Nielsen v. Gillespie,* 97 Cal. App. 319, 275 Pac. 500 (1929); *Delaney P. & R. Co. v. Crystal Petroleum Products Co.,* 88 Cal. App. 784, 264 Pac. 521 (1928). Appellant has not prosecuted its claim to judgment against the Sacramento Northern Railway. Unless and until it has done so, and the judgment shall have been returned unsatisfied, it has no standing to bring suit against The Western Pacific Railroad Company, the Appellee herein, upon any alleged indebtedness of the latter to the Sacramento Northern Railway.

V. The Bankruptcy Court Was Without Jurisdiction to Modify the Final Order Upon the Petition of the Appellant.

By a petition filed in the reorganization proceeding on March 18, 1946, the Reorganization Committee requested a Final Order terminating the proceeding. The bankruptcy court on that day directed that a hearing be held on the petition on March 28, 1946 and that notice of the hearing be sent to all parties to the reorganization, including Appellant. Notice was sent as directed. The bankruptcy court on March 28, 1946, after hearing, signed and filed the Final Order discharging the debtor from all of its liabilities (except as otherwise expressly provided) and closing the proceeding (Tr. 108-15). The objections to the Final Order which Appellant now asserts could have been but were

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been outlawed, may be required to pay what is due as a condition to obtaining affirmative equitable relief. It is impossible to assimilate that case to the instant case, in which a reorganized company is resisting the assertion of a discharged and barred claim. The prime purpose of the discharge and bar order is to afford exactly this protection and there is nothing whatever inequitable in the reorganized company's relying upon it.

not asserted by Appellant at the hearing upon the petition of the Reorganization Committee, nor did Appellant appeal from the Final Order. Under these circumstances, the bankruptcy court has no jurisdiction to modify the Final Order as sought by Appellant. *Duebler v. Sherneth Corp.,* 160 F.2d 472 (C.C.A. 2, 1947); *Reese v. Beacon Hotel Corp.,* 149 F.2d 610 (C.C.A. 2, 1945); *In re Sherland Bldg. Corp.,* 29 F. Supp. 985 (N.D. Ind. 1939).

The bankruptcy court has no jurisdiction, without first reopening the case, to modify its Final Order in a bankruptcy proceeding in the absence of an appropriate reservation of jurisdiction.* *In re Argyle-Lake Shore Corp.,* 98 F.2d 372 (C.C.A. 7, 1938); *In re Peyton Realty Co.,* 148 F.2d 771 (C.C.A. 3, 1945); *In re Wedgewood Hotel Co.,* 125 F.2d 327 (C.C.A. 7, 1942); *In re Corona Radio & Television Corp.,* 102 F.2d 959 (C.C.A. 7, 1939).

In the present case, the bankruptcy court reserved no jurisdiction to modify its Final Order and Appellant's petition is in no sense a petition to reopen the case.

More than this, the Final Order in a bankruptcy proceeding is an adjudication *in rem*† and binds everybody, "including even the holders of claims or interests not filed or scheduled in the proceeding or who had no notice of it." 6 *Collier on Bankruptcy* (14th Ed.) Sec. ~~77.02~~ 11.18, pp. ~~468, 469~~ 3922.

A court sitting in a bankruptcy proceeding will not in any event reopen a case where, as here, it has no power to grant the ultimate relief sought. *Duebler v. Sherneth Corporation,* 160

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*It has been held that "reservation of jurisdiction beyond what is requisite to effectuate a plan of reorganization is beyond the power of the reorganization court." *Reese v. Beacon Hotel Corp.,* 149 F.2d 610, 611 (C.C.A. 2, 1945) (citing cases).

†In the leading case of *Local Loan Co. v. Hunt,* 292 U.S. 234, 241 (1934), the Supreme Court said:

> "And, generally, proceedings in bankruptcy are in the nature of proceedings *in rem,* adjudications of bankruptcy and orders of discharge being, as this court clearly has treated them, in every essential particular decrees in equity determining a '*status.*'"

F.2d 472 (C.C.A. 2, 1947); *Milando v. Perrone,* 157 F.2d 1002 (C.C.A. 2, 1946); *Phillips v. Tarrier Co. of Delaware,* 93 F.2d 674 (C.C.A. 5, 1938).

VI. The Bankruptcy Court, Even if It Had Jurisdiction to Modify the Final Order, Should Not Exercise That Jurisdiction Under the Circumstances Here Presented.

There is no equity in Appellant's petition for modification of the Final Order so as to permit the institution of its proposed suit. If this Court should conclude that the bankruptcy court had jurisdiction, in its discretion, to modify the Final Order at the request of Appellant, the bankruptcy court should properly refuse to exercise that authority for the following reasons:

(a) The divisions of rates between Sacramento Northern Railway and The Western Pacific Railroad Company were established at a time when the Appellant, as parent of the railroad group of which the Sacramento Northern Railway and The Western Pacific Railroad Company were members, had full control over such divisions of rates.

(b) Appellant for many years prior to the reorganization and at all times during the reorganization was familiar with such divisions of rates and did not complain of them. Presumptively Appellant was satisfied that the divisions were entirely just to the Sacramento Northern Railway, as Appellee believes them to have been.

(c) Appellant was not only a party to the reorganization proceeding but, prior to the confirmation and consummation of the reorganization plan, was the sole stockholder of the debtor company and one of its largest unsecured creditors. Although Appellant presented its claims as a stockholder and unsecured creditor, it failed to present the claim which it now seeks to assert.

(d) Appellant represents that the claim which it now seeks to assert, and which it failed to present or assert during the reorganization proceeding, is entitled to priority over the preexist-

ing bond mortgages of the debtor, and should rank with the reorganized company's current liabilities. Thus, Appellant seeks to gain priority, for an unsecured claim which it failed to present or assert during the reorganization proceeding, over the secured claims of creditors found to be entitled to priority under the plan of reorganization heretofore consummated.

(e) Since the entry of the Final Order, the reorganized company has conducted its business, and investors have purchased and held securities of the reorganized company, in reliance upon the Final Order, and such reliance makes modification of the order inequitable.

Under circumstances such as these, the reorganization court will not entertain a request for modification of a final order in a reorganization proceeding. *Mohonk Realty Corp. v. Wise Shoe Stores, Inc.,* 111 F.2d 287 (C.C.A. 2, 1940), cert. den. 311 U.S. 654; *Knapp v. Detroit Leland Hotel Co.,* 153 F.2d 715 (C.C.A. 6, 1946); *In re Tom Moore Distillery Co.,* 52 F. Supp. 938 (W.D. Ky. 1943); *In re McCrory Stores Corp.,* 19 F. Supp. 367 (S.D. N.Y. 1937); *In re Peyton Realty Co.,* 148 F.2d 771 (C.C.A. 3, 1945); *In re Universal Lubricating Systems, Inc.,* 71 F. Supp. 775 (W.D. Pa. 1947).

If it were to be assumed that the bankruptcy court had authority, in its discretion, to modify the Final Order as sought by Appellant's petition, certainly it could not be concluded that the bankruptcy court abused its discretion in denying Appellant's petition.

CONCLUSION

Preliminarily we noted that the order which Appellant seeks to have reviewed upon appeal is non-appealable. We believe that objection to be fatal to the maintenance of this appeal.

Should the Court be in doubt as to the appealability of the challenged order, we think demonstration has been afforded that

(1) the ruling of the bankruptcy court, by order entered on March 19, 1947 in the contempt proceeding, is *res judicata* of the issue which Appellant seeks to relitigate;

(2) it was correctly determined by Judge St. Sure's order of March 19, 1947 in the contempt proceeding that Appellant's claim is barred by the Final Order of March 28, 1946 in the reorganization case;

(3) Appellant has no standing to assert claims of Sacramento Northern Railway against Appellees since a claimant who has not reduced his claim to judgment is not entitled to maintain a creditor's bill or to seek any equitable relief in connection with claims which the alleged debtor may have against third persons;

(4) the bankruptcy court was without jurisdiction to modify the Final Order upon Appellant's petition since (a) such jurisdiction was not reserved, (b) a reservation of jurisdiction beyond what is requisite to effectuate a plan of reorganization, is without the power of the reorganization court, and (c) a bankruptcy court will in no event reopen a case where it has no power to grant the ultimate relief sought;

(5) there is no equity in Appellant's petition designed to secure authority to institute or reinstitute a suit whereby Appellant's unsecured and barred claim would be accorded priority over secured claims the holders of which have accepted bonds and stock in the reorganized company.

The order of the District Court denying Appellant's petition for clarification or modification of the Final Order in the bankruptcy proceeding should be affirmed.

Respectfully submitted,

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Dated: San Francisco, California,
June 16, 1949